

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

Mail Processing Network)
Rationalization Service Changes, 2012)

Docket No. N2012-1

INITIAL BRIEF

OF

VALPAK DIRECT MARKETING SYSTEMS, INC., AND
VALPAK DEALERS' ASSOCIATION, INC.
(July 10, 2012)

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STATEMENT OF THE CASE

On December 5, 2011, the Postal Service filed its “Request of the United States Postal Service for an Advisory Opinion on Changes in the Nature of Postal Services.” The Postal Service began a process to consider reducing the number of mail processing facilities to enable it to eliminate overnight delivery for First-Class Mail and Periodicals. The initial request was supported by the direct testimony of 13 postal witnesses:

David E. Williams	USPS-T-1
Stephen Masse	USPS-T-2
Emily R. Rosenberg	USPS-T-3
Frank Neri	USPS-T-4
Dominic L. Bratta	USPS-T-5
Cheryl D. Martin	USPS-T-6
Pritha N. Mehra	USPS-T-7
Kevin Rachel	USPS-T-8
Marc A. Smith	USPS-T-9
Michael D. Bradley	USPS-T-10
Rebecca Elmore-Yalch	USPS-T-11
Greg Whiteman	USPS-T-12
Susan M. LaChance	USPS-T-13

On December 7, 2011, the Commission issued Order No. 1027, “Notice and Order Concerning Request for an Advisory Opinion Regarding the Revision of Service Standards for First-Class Mail, Periodicals, Package Services, and Standard Mail,” commencing this docket. Valpak Direct Marketing Systems, Inc. and Valpak Dealers’ Association, Inc. (hereinafter “Valpak”) intervened on December 30, 2011. Hearings on the Postal Service’s direct case were held on March 20-23, 2012. The Postal Service submitted supplemental testimony for:

Dominc L. Bratta (USPS-ST-1)
Cheryl D. Martin (USPS-ST-2)
Marc A. Smith (USPS-ST-3)
Michael D. Bradley (USPS-ST-4)
Frank Neri (USPS-ST-5)

The Postal Service announced a modified plan on May 17, 2012,¹ which prompted Commission Information Request No. 1, and a hearing was held on the modified plan on June 7, 2012.

Substantial rebuttal testimony was submitted by six parties: American Postal Workers Union (“APWU”), National Association of Letter Carriers (“NALC”), National Newspaper Association (“NNA”), National Postal Mail Handlers Union (“NPMHU”), the Public Representative (“PR”), and the Postal Regulatory Commission (“PRC”), as follows:

Kathryn Kobe	APWU-RT-1
Marc Schiller	APWU-RT-2
Pierre Kacha	APWU-RT-3
Michael Crew	NALC-T-1
Max Heath	NNA-T-1
David Bordewyk	NNA-T-2
Michael Hora	NPMHU-T-1
Paul Hogrogian	NPMHU-T-2
Christopher Bentley	NPMHU-T-3
James Haggarty	NPMHU-T-4
David Wilkin	NPMHU-T-5
Kenny Hayes	NPMHU-T-6
Robert J. Broxton, Sr.	NPMHU-T-7
Kevin Neels	PR-T-1
Subramanian Raghavan	PR-T-2
William Weed	PRCWIT-T-1
Harold J. Matz	PRCWIT-T-2

The Commission held hearings on the testimony of the rebuttal witnesses on June 13-14, 2012.

On June 22, 2012, the Postal Service submitted the surrebuttal testimony of four witnesses:

¹ Postal Service press release, “Postal Service Moves Ahead with Modified Network Consolidation Plan,” May 17, 2012, http://about.usps.com/news/national-releases/2012/pr12_058.htm.

Frank Neri	USPS-SRT-1
Marc A. Smith	USPS-SRT-2
Marc McCrery	USPS-SRT-3
Rebecca Elmore-Yalch	USPS-SRT-4

The Commission held a hearing on the surrebuttal testimony on June 28, 2012.

Pursuant to Presiding Officer's Ruling ("POR") No. N2012-1/5 (Jan. 12, 2012), the deadline for initial briefs is July 10, 2012, and that for reply briefs is July 20, 2012.

ARGUMENT

I. The Postal Service Has Done a Good Job Identifying and Assessing the Legal Principles Set Out in Law.

Giving the matter significantly more attention than in prior N-dockets, the Postal Service has done a workmanlike job of identifying and analyzing the postal statutes that bear on its proposal. *See* USPS Request, pp. 5-11. It is gratifying that the Postal Service has embraced the argument made in Valpak's Initial Brief in Docket No. N2011-1,² in concluding that section 101(b) requires only "a maximum degree of regular and effective ... service, not **the** maximum degree." USPS Notice, p. 9 n.11 (emphasis original).

Not mentioned by the Postal Service, however, are the principles contained in 39 U.S.C. section 101(g) which specifically apply to new postal facilities. Valpak continues to believe that these principles should be kept in mind for evaluating existing facilities: "the need for facilities and equipment designed to create desirable working conditions for its officers and employees, a maximum degree of convenience for **efficient** postal services, proper access to

² Valpak Initial Brief, Docket No. N2011-1 (Nov. 4, 2011), pp. 10-13, <http://www.prc.gov/Docs/77/77416/VP%20N2011-1%20Initial%20Brief.pdf>.

existing and future air and surface transportation facilities, and **control of costs** to the Postal Service” (emphasis added). Additionally, Valpak believes that several objectives and factors of the market dominant pricing system at least implicitly refer to costs and efficiency of the Postal Service which indirectly bear on the Postal Service’s mail processing network. *See, e.g.,* 39 U.S.C. § 3622(b) and (c).

The “standard of review” for the Commission Advisory Opinion is that, after a “hearing on the record,” it must “conform[] to the policies established under this title,” and such conformance must be certified by each agreeing Commissioner. 39 U.S.C. § 3661(c). The Commission has many theoretically conflicting statutory provisions within Title 39 that it must balance when providing its Advisory Opinion to be issued in this docket, and it must be careful not to focus narrowly on one provision of law while neglecting others.

In addition to focusing on the needs of First-Class and Periodicals mailers for service, the Commission also has a responsibility to consider the Postal Service’s proposal in the context of the provision of law relating to maintaining the financial health of the Postal Service and its near-desperate need to achieve increased efficiencies and cost savings. If the Commission were to disregard the provisions of law relating to the need to achieve a financially stable Postal Service, its Advisory Opinion would be flawed.

II. Congress' Micro-management of Postal Service Cost Cutting Has Forced the Postal Service to Focus on Areas where It Has Discretion, Not Necessarily where It Would Do the Least Harm.

The Postal Service's efforts to cut costs by consolidating processing plants and reducing service standards need to be reviewed in the context of its other cost-cutting efforts and Congressional constraints on cost cutting.

There should be no question that deep spending cuts are required. Whether measured in terms of mail volume or operating revenue, the Postal Service has been suffering hard times for much of the last decade³:

Total Mail Volume. Total mail volume, an important indicator of the health of the Postal Service, peaked at 213.1 billion pieces in FY 2006. Viewed over the past decade, total volume has declined from 202.8 billion pieces in FY 2002 to **163 billion in FY 2011.**⁴

First-Class Mail Volume. It is the volume trend for highly profitable First-Class Mail volume which is of particular importance, as the service standard changes proposed in this docket primarily relate to First-Class Mail. The all-time high water mark for Postal Service First-Class Mail volume was 103.656 billion pieces, which occurred in FY 2001, five years before the total mail volume peak. This number for FY 2001 would have been even higher, but for the events of 9-11 affecting mail during the last three weeks of FY 2001. Of course, the full financial effect of 9-11 was not

³ See generally testimony of Stephen Masse, USPS-T-2, <http://www.prc.gov/Docs/78/78319/USPS-T-2-Masse.pdf>.

⁴ <http://about.usps.com/who-we-are/postal-facts/welcome.htm>.

felt until FY 2002, when First-Class Mail volume fell to 102.379 billion. In retrospect, as difficult as FY 2002 was for the Postal Service, that time frame might now be looked back on as the “good old days” — the last year that First-Class Mail volume exceeded 100 billion pieces. During the long economic slowdown that is often dated as having begun in earnest during September 2008, Postal Service volume slipped further to **73.8 billion in 2011**.⁵ Witness Masse “expects First-Class Mail volume to decline ... to 39 billion pieces in 2020.” USPS-T-2, p. 4.⁶

Operating Revenue. Operating Revenue declined from \$74.778 billion in FY 2007 to **\$65.711 billion in FY 2011**. The high water mark for Operating Revenue was \$74.9 billion in FY 2009, and from that point, revenues declined \$6.8 billion in one year.

Faced with such volume and revenue fall-off, the Postal Service has responded admirably to the crisis by doing such cost cutting as was in its power — whether measured in terms of Postal Service expenditures or Postal Service employees.⁷

⁵ <http://about.usps.com/who-we-are/postal-history/first-class-mail-1926-2010.pdf>.

⁶ It is certainly not that communication generally has slowed, for the use of e-mail has exploded, with 625 million e-mail addresses in 2003 growing to 3.1 billion in 2011, <http://img.techcress.com/2011/12/History-of-emails.jpg>.

⁷ <http://about.usps.com/who-we-are/postal-facts/welcome.htm>.

Postal Service Expenditures. The Postal Service has made great strides to reduce the costs within its control. However, meaningful year-to-year comparisons of expenditures are difficult to make, as each year has unique characteristics.⁸

Postal Service Career Employees. What can be compared is the number of employees year over year. The Postal Service's high water mark of total career employees occurred in FY 2002 at 752,949, and has declined every year since then, to 551,570 employees in FY 2011. Postal Service witness Masse describes the "extraordinary cost-reduction efforts" of the Postal Service where, since 2006, the Postal Service has eliminated "310 million workhours, or 21 percent of the 2006 total." USPS-T-2, p. 7. A reduction of over 200,000 employees in a decade demonstrates the Postal Service's serious efforts, including encouraging early retirement⁹ and imposing restrictions on new hiring.

Of course, the Postal Service is not the only company making cuts. The entire mailing industry suffered cuts during the Great Recession, and because private firms have fewer constraints on cost cutting, those cuts came earlier for the private sector than for the Postal Service. The Postal Service operates under a special set of constraints imposed by Congress,

⁸ See, e.g., Postal Regulatory Commission, Annual Compliance Determination Report FY 2011 (Mar. 28, 2012), pp. 25-26, <http://www.prc.gov/Docs/81/81771/FY%202011%20ACD.pdf>.

⁹ One illustrative current program offers a \$15,000 incentive for early retirement by Mail Handlers, <http://www.foxnews.com/politics/2012/05/26/postal-service-offers-buyouts-with-15k-incentive-in-latest-cost-cutting-plan/>. Another program is the \$20,000 incentive for Postmasters, <http://www.fedsmith.com/article/2812/postal-service-cutting-jobs-offering-k.html>.

and the Postal Service has been stymied by Congress with respect to cost cutting, resulting in the Postal Service making the cuts that **it could make**, not necessarily the cuts that it **wanted to make** to do the least damage to the company.

Perhaps the most obvious illustration of Congressional interference has come from the continued Congressional blocking of the Postal Service's effort to end Saturday delivery. In 2008, the Postal Service conducted a study of five-day delivery, determining that it would save \$3.5 billion annually. The Postal Service revealed its reluctant decision to move to five-day delivery during Postmaster General John Potter's testimony at a January 29, 2009 Congressional hearing.¹⁰ Detailed analysis of the five-day proposal at the Postal Service began in March 2009.¹¹ On March 2, 2010, General Potter announced that the Postal Service would seek an advisory opinion from the Commission — a filing that was made on March 30, 2010.¹² The proposal was fully examined in a hearing on the record. The Commission issued its Advisory Opinion on March 24, 2011¹³ — just a few days short of one year later. Although the Commission's lengthy consideration was not helpful to cost savings, it did not impose the principal impediment to these savings being instituted. Unfortunately, thus far Congress has been unwilling to allow this important change to be made. The House Appropriations

¹⁰ Wendy R. Ginsberg, Congressional Research Service, "The U.S. Postal Service and Six-Day Delivery: Issues for Congress" (Apr. 12, 2010), p. 1.

¹¹ Testimony of Sam Pulcrano, USPS-T-1 (Mar. 30, 2010), p. 5, <http://www.prc.gov/Docs/67/67407/PULCRANO.FINAL.pdf>.

¹² Postal Service Request for an Advisory Opinion (Mar. 30, 2010), <http://www.prc.gov/Docs/67/67402/Request.FINAL.pdf>.

¹³ Postal Regulatory Commission Advisory Opinion (Mar. 26, 2011), http://www.prc.gov/Docs/72/72327/Advisory_Opinion_032411.pdf.

Committee recently reported out a bill which would bar the Postal Service from moving to five-day delivery,¹⁴ and which also provides “[t]hat none of the funds provided in this Act shall be used to consolidate or close small rural and other small post offices in fiscal year 2013.”

While it is unclear whether this language will be contained in the final appropriations bill, it is illustrative of the impediments to cost cutting faced by the Postal Service, and which helped lead to the instant docket.

Valpak believes that degradation of service should be one of the last cost-cutting measures which the Postal Service should make and that other changes such as the move to 5-day delivery should come first. Although it is possible to view the move to 5-day service as a reduction in service, as mail not delivered on Saturday would need to be delivered on Monday, that change is necessitated by the reduction in mail volumes over the past few years, as well as the March 2, 2010 projection made by Boston Consulting Group, Inc. that the number of pieces per delivery point will fall further from four pieces daily in 2009 to three pieces in 2020.¹⁵ The issue in Docket No. N2010-1 was not whether the annual cost savings will be in

¹⁴ H.R. 6020, 112th Cong., 2d Sess. (Jun. 26, 2012), p. 95 (“Provided further, That 6-day delivery and rural delivery of mail shall continue, at not less than the 1983 level....”), <http://www.gpo.gov/fdsys/pkg/BILLS-112hr6020rh/pdf/BILLS-112hr6020rh.pdf>.

¹⁵ Boston Consulting Group, Projecting U.S. Mail Volumes to 2020 (Mar. 2, 2010) (“We forecast U.S. postal volumes to decrease from 177B pieces in 2009 to around 150B pieces in 2020 under business-as-usual assumptions. Notably, volumes will not revisit the high-water-mark of 213B pieces in 2006 – on the contrary, the trajectory for the next 10 years is one of steady decline, which will not reverse even as the current recession abates. Expressing the decline in terms of pieces per delivery point highlights the challenge: we project pieces per household per day to fall from **four** pieces today to **three** in 2020 – driven by decreasing volumes delivered to an increasing number of addresses.” P. 2 (emphasis added).) <http://about.usps.com/future-postal-service/gcg-narrative.pdf>.

the \$2 billion range forecast by the Postal Regulatory Commission or the \$3 billion range forecast by the Postal Service, but that there are simply not enough pieces to justify sending a carrier out on the street six days per week.

Whenever service is degraded more fundamentally, as is being proposed in this docket, it is essential that the Postal Service fully understand the consequences of its action. The Postal Service needs to understand what mailers need in the product they are purchasing, which changes mailers can accept, and which changes would drive them from the mail. This docket has provided the public vehicle by which the Commission can assure itself that the Postal Service is fully aware of mailer needs, and that it understands the full consequences of its decision before implementing changes. This is why the statutory requirement for a hearing on the record¹⁶ is wise, and has been demonstrated to be helpful and productive. *See* Section V, *infra*.

If all cost-cutting options had been on the table, it might have been that the Postal Service would not want or need to implement the service standard changes in this docket. However, Congress has limited the Postal Service's options, and to ensure the financial survival of the company, it is necessary for the Postal Service to pick the best choice from a narrowly constricted set of options. The Commission must view this proposal within the context of those choices which are legally available to the Postal Service, and not those choices which are only theoretically possible.

¹⁶*See* 39 U.S.C. § 3661(c).

III. The Postal Service Has Contributed to Putting Itself in the Position of Having to Degrade Service to Save Costs Due to Deliberate Underwater Pricing of Certain Products.

The Postal Service's proposal is submitted in the context of continuing financial difficulties, with the Postal Service projected to lose \$3 billion in FY 2012 without considering the currently mandated Retiree Health Benefits Fund payments. *See* Testimony of Stephen Masse (USPS-T-2), pp. 5-10. Although some of the difficulties are politically imposed by Congress (*see* Section II, *supra*), some problems are self-inflicted.

Despite these admittedly enormous financial difficulties, the Postal Service continues to pursue a pricing strategy designed to lose money, by intentionally (or at least knowingly) underpricing and encouraging losses from several underwater products. Most recently, Valpak has discussed these items in detail in the last annual compliance review. *See* Docket No. ACR2011, Valpak Initial Comments, pp. 41-45.¹⁷ In FY 2011 alone, the Postal Service lost \$1.6 billion on products whose prices did not cover the costs of providing the service for those products. Of that, over \$1.1 billion was on two products: Outside County Periodicals and Standard Flats.

**Loss-Generating Market Dominant Products, FY 2010-2011
(Exclusive of Special Services)**

Product	FY 2010 Deficit (\$, millions)	FY 2010 Cost Coverage	FY 2011 Deficit (\$, million)	FY 2011 Coverage
First-Class Parcels	\$1	99.9%	—	—

¹⁷ <http://www.prc.gov/Docs/80/80280/VP%20ACR2011%20Initial%20Comments.pdf>.

Inbound Int. Single-Piece First-Class Mail	\$53	79.3%	\$36	79.0%
Standard Mail Flats	\$582	81.6%	\$652	79.3%
Standard Mail NFMs and Parcels	\$178	77.2%	\$117	84.8%
Periodicals Within County	\$25	74.2%	\$20	77.5%
Periodicals Outside County	\$598	75.0%	\$597	74.5%
Single-piece Parcel Post	\$134	82.1%	\$89	89.2%
Bound Printed Matter Parcels	\$28	92.1%	\$5	98.4%
Media and Library Mail	\$90	80.4%	\$99	77.0%
Total	\$1,689		\$1,615	

Sources: Tables 1-4, FY 2010 ACR; Tables 1-4, FY 2011 ACR.

The Periodicals class has lost nearly \$5 billion over the past 15 years. And there is no end in sight, as the Postal Service and the Commission’s Joint Periodicals Mail Study confirm that the problem will not be solved under a price cap regime. *See* Docket No. ACR2011, Valpak Initial Comments, pp. 59-69.

In the FY 2010 ACD, the Commission determined that Standard Mail Flats was not in compliance with the Postal Accountability and Enhancement Act (“PAEA”), the Commission making a similar determination in its FY 2011 ACD. The Standard Mail Flats product has lost over \$2 billion under PAEA, and it is fully expected to lose nearly \$600 million more in FY 2012, as the Postal Service continues to intentionally price it at or below average price increases, in violation of PAEA. The most recent price increase constituted *de minimis*

compliance with the Commission's order to give Standard Flats above-average price increases, and even this nominal compliance was essentially wiped out with the discounts provided in the FY 2012 mobile barcode discount.

Recently, the U.S. Court of Appeals for the D.C. Circuit confirmed the Commission's finding of noncompliance in the FY 2010 ACD. *See U.S. Postal Service v. Postal Regulatory Commission*, No. 11-1117 (D.C. Cir., Apr. 17, 2012). (The court's mandate was issued on June 12, 2012.) Although the case has been remanded to the Commission for further proceedings, the Commission's stay of its remedial order expired 30 days after the court's decision. *See* Order No. 739 (May 27, 2011). The Commission needs to act soon to resolve the issues that are now on remand, and the Postal Service should be directed to comply with the Commission's order to submit a schedule of above-CPI price increases, and then implement those increases.

The annual total losses from underwater products exceed what some estimate to be the savings from the Postal Service's proposed service standards in this docket. Because of these ongoing losses from underwater products, there is unnecessary pressure to implement the Postal Service's proposal in this case. While correcting the problem of underwater products would not be sufficient to bring the Postal Service to breakeven, a sincere effort of the Postal Service to correct the pricing of underwater products could help keep the ship afloat. Current Postal Service pricing of underwater products simply maintains unfair preferences for some and unfair discrimination against others (requiring mailers of profitable products to subsidize the mailers of underwater products). It also demonstrates bad business practice.

IV. Testimony Provided by Witnesses Matz, Weed, Reghavan, and Kacha Assists in the Commission's Consideration of the Postal Service Proposal.

A. Introduction

In light of the decline in mail volume discussed in Section II, *supra*, no party could seriously contest that the Postal Service now has too many facilities and excess mail processing capacity. Hence some level of consolidation clearly is required. However, consolidation need not necessarily imply reductions in service standards. The Postal Service from time to time has successfully used its AMP process to consolidate some relatively nearby facilities with no reduction in service standards,¹⁸ and such further consolidations may well be possible. Had the Postal Service limited its plant consolidations to those that could be accomplished with no change in service standards, no advisory opinion from the Commission would appear to have been necessary.¹⁹

At some point, though, consolidation necessitates some sacrifice in service standards. Beyond that point, it becomes necessary to start making trade-offs between (i) reductions in service standards, and (ii) further plant consolidations coupled with possible cost savings.

¹⁸ See, e.g., testimony of Witnesses Weed/Matz regarding the consolidation of the Tacoma, WA facility into the Seattle, WA plant.

¹⁹ Supplemental testimony of Witness Pierre Kacha, APWU-ST-2 (filed June 12, 2012), reports results of a network simulation exercise that incorporates the actual facility closures proposed by the Postal Service on May 17, 2012. According to that supplemental testimony, results of this simulation exercise “show that the impact on inter-SFC [sic] overnight delivery will be minimal. This suggests that the Postal Service can implement the consolidations planned for this summer **while maintaining the current service standards.**” p. 3, ll. 10-12 (emphasis added).

Persuasive intervenor testimony in this docket, discussed *infra*, shows that the original Postal Service Request (Dec. 5, 2011) conflates two or more separate proposals, lumping them together into a single analysis. Unfortunately that all-or-nothing approach by the Postal Service has made the Commission's analytical job more difficult.

The Postal Service could have examined first which facilities could be consolidated with no reduction in service standards for First-Class Mail, along with the cost savings obtainable from such consolidation. Second, the Postal Service's analytic exercise could have relaxed — but need not have eliminated — the existing service standard constraint by retaining overnight delivery for First-Class Mail within the geographic area served by each plant (*i.e.*, no overnight delivery for First-Class inter-plant mail). This would have enabled some further reduction in the requisite number of plants and, hopefully, some further increase in cost savings. The final step in such a sequential analysis would be that specified in the Postal Service Request filed on December 5, 2011. An approach which analyzed alternatives and tradeoffs would have been enlightening for all stakeholders and interested parties and probably more convincing.

The Postal Service took as its baseline for savings estimates the cost of the network as it existed in 2010, and then compared that with almost total abandonment of overnight delivery for First-Class Mail, without making any effort to design one or more intermediate “optimal” networks that could preserve some or all overnight delivery. The Postal Service does not tell us how much could be saved while preserving overnight delivery service, and how much of the cost savings would arise from the proposed change in service standards.

Changes in service standards are high risk decisions, even where the Postal Service has conducted market research.²⁰ Valpak has supported the Postal Service's managerial flexibility to cut costs in numerous prior dockets, but of all the areas where the Postal Service could cut, delivery service standards should receive the greatest scrutiny.

Fortunately, three parties sponsored witnesses who submitted testimony on possible trade-offs, to the effect that the Postal Service could achieve a substantial portion of its anticipated cost savings while concurrently retaining overnight delivery for all First-Class Mail within the area served by each plant.²¹ Discussed below are the four witnesses who provided helpful testimony through their discussion of the pertinent tradeoffs:

- PR witness Subramanian Raghavan, PR-T-2;
- APWU witness Pierre Kacha, APWU-RT-3;
- PRC witness Harold J. Matz, PRCWIT-T-2; and
- PRC witness William Weed, PRCWIT-T-1.

B. PR Witness Raghavan Demonstrates that Significant Cost Savings May Be Achievable while Preserving the Current Service Standards.

The Postal Service has used a detailed and complex modeling effort to assist in a planning exercise of unprecedented scope, reducing the 477 plants currently in the mail

²⁰ Market research is presented in testimony of witnesses Rebecca Elmore-Yalch, USPS-T-11, and Greg Whiteman, USPS-T-12. Market research is desirable, probably necessary, but not infallible. Introduction of the *Edsel* was preceded by considerable market research.

²¹ On May 17, 2012, the Postal Service announced a revised schedule for closure of some mail processing facilities, but the proposal to dramatically reduce First-Class service standards is only delayed, not altered.

processing network to a much smaller number. According to the Postal Service, elimination of overnight delivery for most First-Class Mail is necessary to achieve significant cost savings.²²

While the Commission's Advisory Opinion in this docket concerns the change in service standards, estimates of cost savings from operational changes clearly are at issue because, if the cost savings cannot be achieved or are seriously overestimated, then there would be little justification for exposing the Postal Service to the risk of degrading service standards.

Witness Raghavan provides an insightful critique of the Postal Service's modeling effort in which he shows how projected cost savings of the Postal Service's rationalized network may be seriously overstated.

1. Postal Service witness Rosenberg "completely ignored the transportation costs between mail processing facilities in her analysis." PR-T-2, p. 13, ll. 14-5.
2. Problems arising from staging of mail were not considered.

Under the proposed service standard and mail processing environment the same piece of mail will not count as originating mail and destinating mail on the same day. From an operational perspective, the implication of this observation is that the **staging space for mail is going to increase very significantly**. The analysis of the layout of a facility needs to account for this critical fact, and ensure that there is adequate space to deal with the originating and destinating mail inventories separately. **None of witness Rosenberg's (or any of the other Postal Service witnesses) analysis discusses this issue.** [*Id.*, p. 21, ll. 14-21 (emphasis added).]

²² Under the rate making system established by PAEA, reductions in service performance (or service standards) to reduce costs should be viewed as a violation of the rate cap. The purpose of the elaborate performance measurement system being installed by the Postal Service is to assure that service is not reduced as an end run around the rate cap.

3. The Postal Service's estimate of productivity improvements and \$964 million of cost savings associated with the rationalized network under the proposed service standard is uncertain:²³

There are several critical assumptions associated with [witness Neri's] computation. As I will show[,] any changes from these assumptions result in widely varying estimates of productivity improvements, thereby raising significant doubts about the savings due to productivity improvements in the Postal Service's case. [*Id.*, p. 29, ll 19-22 (underscore original).]

It is axiomatic that a question never asked likely will be a question never answered.

Thus, at the outset of witness Raghavan's testimony, he poses a critical, unaddressed question:

An important question that is **not addressed** in Postal Service case set forth in Docket No. N2012-1 is an estimate of the cost savings associated with an optimized mail processing network **that preserves the current service standard.** This would provide a comparative analysis to the rationalized network under the proposed service standard. [*Id.*, p. 3, ll. 19-22 (emphasis added).]

Raghavan uses the essential elements of the Postal Service's model and data to answer this important question as follows:

My analysis shows that maintaining the current service standard, using the Postal Service's Logic Net model, results in a network that has somewhere between 239 and 277 facilities.... Thus it should be clear that **some significant savings could be achieved** by optimizing the current mail processing network **under today's service standard.** While this saving would be less than that

²³ Some of the Postal Service's projected cost savings from cutback in the total number of facilities arises from the fact that with its existing equipment the outgoing secondary sortation can be eliminated. One wonders why current equipment cannot be expanded to accomplish an initial outgoing sort to somewhere between 230 and 280 destinations. That modification would enable elimination of the outgoing secondary sort while maintaining the overnight service standard for First-Class Mail.

achievable by changing the service standard, it may **have fewer risks** associated with declines in revenue because of the change in service standard. [*Id.*, p. 45, ll. 12-18, (emphasis added).]

PR witness Raghavan, who teaches operations research, believes the best practice in an “optimizing” exercise such as that being conducted by the Postal Service requires multiple steps. First, compute maximum savings obtainable while maintaining the constraint of overnight service for First-Class Mail. Second, relax that constraint in order to isolate how much additional savings would be obtained from some degree of service degradation (in the manner proposed by the Postal Service, or in some intermediate manner such as maintaining overnight delivery only for mail within the area served by each mail processing plant).²⁴ While Title 39 does not require use of best practices, Raghavan does illustrate how the Postal Service might have presented its case better.

C. APWU Witness Kacha’s Network Simulation Model Demonstrates that a Large Number of Plants Can Be Consolidated while Retaining Overnight Service for First-Class Mail.

APWU witness Kacha presents a detailed network simulation model that originally was developed for the USPS OIG and then updated with Postal Service data filed in this case.

APWU-RT-3, p. 2. The current overnight service standard for First-Class Mail is maintained in each scenario, and no other service standards were tested. Response to USPS/APWU-RT3-

5. Like any simulation exercise, the model contains a number of simplifying assumptions

²⁴ Witness Raghavan’s testimony is both lengthy and technical. It likely could not have been prepared without information derived from interrogatories, nor could it have been prepared within the span of four to five weeks, the period for initial comments in ACR dockets. *See* Section V, *infra*.

(*e.g.*, the model is deterministic, with no stochastic variation in mail volume).²⁵ Response to USPS/APWU-RT3-10. It nevertheless offers valuable insight to the critical tradeoffs at issue in this case — *i.e.*, tradeoffs between changes in service standards and cost savings provided by alternatives not presented by the Postal Service.

Witness Kacha presents tables showing the results from seven scenarios, each depicting a different level of consolidation in the number of mail processing facilities, scaling down from the current 477 to 250 mail processing plants. In this manner, the network simulation model helps demonstrate the effect on cost and service performance from various levels of consolidation.²⁶ As the number of plants is scaled down from 477 to 250, some degradation in service performance is seen to occur. *Id.*, Table 1, p. 3. The estimate of total operating costs for each scenario, from which cost savings can be computed, also are shown. *Id.*, Table 2, p. 5. Combining results from these two tables, one can see the critical tradeoffs between costs and service performance. This simulation exercise indicates that the Postal Service could obtain most of its projected cost savings without abandoning the overnight service standard for First-Class Mail. Achievement of maximum savings, however, requires the Postal Service's proposed change of service standards.

²⁵ Witness Kacha notes that “[d]ue to lack of time, we did not test the effects of more stringent, but quite plausible, operating conditions.” *Id.*, p. 4, ll. 10-11.

²⁶ Witness Raghavan criticizes the Postal Service for not using a simulation model to test the results of their optimizing exercise. “A third concern is the lack of any simulation studies to analyze a mail processing facility under the proposed service standard.” PR-T-2, p. 22, ll. 5-6.

D. PRC Witnesses Matz and Weed Present Alternatives Designed to Enable the Postal Service to Retain Much Overnight Service for First-Class Mail while Achieving Substantial Cost Savings.

Testimony by PRC witness Harold Matz, PRCWIT-T-2, which is supported by PRC witness William Weed, PRCWIT-T-1, is critical of the Postal Service's presentation. Like witnesses Raghavan and Kacha, discussed *supra*, they too were struck by the Postal Service's failure to present any alternatives or discuss tradeoffs between service standards and cost savings.

The Postal Service did **not** substantially **evaluate other alternatives** to the Mail Processing Network Rationalization Service Change (NRSC) scenario, as defined by the N2012-1 docket.... My testimony will ... **present an alternative concept** that would preserve more than half of the OND [overnight delivery] service while still creating the opportunity to capture a large portion of the N2012-1 savings. [PRCWIT-T-2, p. 1 (emphasis added).]

Although witness Matz does not work with or offer a comprehensive "model" of the entire mail processing network, he notes that:

There are two components to OND service: Intra-SCF and Inter-SCF.... N2012-1 does not recognize this distinction. N2012-1 **eliminates all OND**, with the exception of early morning entry of presort, **without considering any other alternatives** to the current OND structure.

Key questions around defining the scope of the OND commitment and quantifying the amount of turnaround mail have **not been answered** in the Postal Service's N2012-1 testimony. [*Id.*, p. 2, ll. 21-20 (emphasis added).]

Witness Matz discusses at some length the plan which he and witness Weed developed for dispensing with overnight delivery for all inter-plant mail, but preserving overnight delivery for all intra-plant mail. Witness Matz concludes his testimony as follows:

In summary, the approach of the Postal Service in N2012-1 **fails to consider alternatives** that would lead to **an incremental consolidation** of the mail-processing network. **The global elimination of OND [overnight delivery] service does not need to occur at this time.** A reduction of the Inter-SCF component of OND would create the opportunity to capture much of the savings outlined in N2012-1. It would require a **new analysis of consolidation alternatives** using the operating plan concepts as outlined in my testimony. The **net savings** projected by the Postal Service **result from an all-or-nothing approach** to closing plants. **Significant savings** could be realized by **selectively** closing plants, while **simultaneously maintaining a high percentage of overnight service.** Witness Williams indicated that the savings potential from maintaining some level of overnight service was not as great as from the proposed change. He also indicated that the organization (USPS) determined to fully evaluate the potential opportunity based on the proposed network laid out docket N2012-1. In my opinion, the Postal Service should not implement N2012-1 as proposed, but should **instead develop a more incremental and rational approach to network consolidation.** [*Id.*, p. 34, l. 19 to p. 35, l. 11 (emphasis added).]

Part of witness Weed's testimony challenges the Postal Service's assumptions concerning productivity in the consolidated network and the associated costs savings. Specifically, his testimony contains a detailed comparison of the before-consolidation productivity at each losing plant slated by the Postal Service for closure versus the productivity at each respective gaining plant. Table 6 on p. 12 of witness Weed's testimony shows that the "losing" plants recorded a higher productivity in all category groupings — with the exception of the SPBS and tray handling groups." *Id.*, p. 11, ll. 17-19. In other words, the Postal Service's own data show that it plans to consolidate smaller plants that are more productive

and more efficient into larger plants known to be less productive and less efficient.²⁷ This means that:

in order to realize mail processing savings expected from the proposed Mail Processing Network Rationalization Service Changes, the gaining facilities will have to achieve a weighted average 20.9 increase in overall productivity. This will require a dramatic improvement in all processing operations, both in volume and non-volume measured operations. [*Id.*, p. 9 (underscore original).]

Witness Weed develops what he describes as a “likely worst case outcome,” in which all gaining facilities process at their existing lower productivity rate all mail received from losing facilities. Rather than the large savings projected by the Postal Service, the result is no savings at all. Instead, hours and costs increase by 2.3 percent. *See id.*, Table 7, p. 15.

Even if witness Weed’s projected outcome is viewed as pessimistic, it raises a legitimate concern as to whether the Postal Service’s projected productivity savings are far too optimistic. As noted previously, only significant costs savings could justify the dramatic reduction in service standards.

V. Thoughtful Rebuttal Testimony Illustrates the Need to Afford Due Process in N-dockets.

On April 10, 2012, the Commission issued Order No. 1309, “Advance Notice of Proposed Rulemaking on Modern Rules of Procedure for Nature of Service Cases Under 39

²⁷ This relationship has been documented previously, *e.g.*, *see* GAO Report 05-261, “The Service’s Strategy for Realigning Its Mail Processing Infrastructure Lacks Clarity, Criteria, and Accountability” (April 2005). Within the Postal Service, however, and despite all the evidence to the contrary, it seems to be an article of faith that bigger is always better. In this docket, with their faith unshaken, they are plunging ahead, reminiscent of the person who is never in doubt, but often wrong.

U.S.C. 3661” initiating Docket No. RM2012-4. In Docket No. RM2012-4, the Commission is considering options to expedite N-dockets by various means, including reducing the role of intervenors. The Commission explained, “The proceedings in Docket No. N2012-1, currently under consideration by the Commission, highlight the challenges that the Commission can face in N-cases.... The Commission has had to balance the competing concerns for due process against the need for expedition.” Order No. 1309, p. 6. Valpak submitted Initial Comments in that docket on June 18, 2012.²⁸

In this N-docket, the intervenors have offered meaningful testimony about the Postal Service proposals, illustrating the desirability and need to preserve the due process rights of intervenors in Advisory Opinion dockets. Intervenors need sufficient time to evaluate Postal Service proposals, to retain expert witnesses, to conduct discovery, to cross-examine witnesses, and to offer alternatives to the Postal Service proposals.

The original request submitted by the Postal Service was lacking in its analysis based on “best” practices for an “optimizing” study. APWU witness Pierre Kacha, PR witness Raghavan, and Commission witnesses Matz and Weed discussed this aspect in their rebuttal testimonies. *See* Section IV, *supra*.

The Postal Service described its decision to conduct the phased implementation: “After considering the formal rulemaking comments, the range of other informal advice it has received, and the results of its market research, and after considering the requirements of 39 U.S.C. 3691 and other applicable provisions of title 39, the Postal Service has determined to

²⁸

<http://www.prc.gov/Docs/83/83080/Valpak%20Initial%20Comments.pdf>

implement Network Rationalization, but on a more gradual timeline than it initially envisioned.” 77 *Fed. Reg.* 31191 (May 25, 2012). This development occurred approximately a month after the filing of intervenor rebuttal testimony.

The Postal Service could have presented such an analysis. Indeed, the Postal Service’s modified plan implements in two phases. The first includes consolidation of 140 facilities of the total of 229, but reduces the overnight delivery service standard by only approximately 20 percent. *See* response of witness Rosenberg to CIR No. 1, questions 4 and 5. Phase two does not take effect until February 1, 2014, and thus could be adjusted based on what the Postal Service learns as it implements phase one.

The essential message from all three of the above parties is that the Postal Service should not rush headlong to its final proposed “reduced” configuration of facilities. Each in their own way assert that a considerable amount of consolidation and cost savings can be achieved without sacrificing overnight delivery for First-Class Mail (and Periodicals) in the geographic area served by each Postal Service plant.

By the Postal Service request to reduce the time for Commission consideration in N-dockets, it would not give intervenors time to develop alternative proposals of the sort made in this docket.

Order No. 1309 discussed an option “to eliminate discovery and restrict cross-examination.” The Postal Service urged this change in its initial comments in Docket No. RM2012-4, recommending that the Commission tightly control discovery and cross-examination, limit the subject matter for discovery, and/or eliminate oral hearings. *See* Postal Service Initial Comments, pp. 12-25. The Postal Service views Commission proceedings as an

irritant. The Postal Service believes the nature of Commission proceedings make it look bad.

“A presumption of relevance, subject to objection, places the political onus on the Postal Service of adopting a defensive posture.... This onus weighs particularly heavily because all discovery in Commission practice plays out publicly and under the Commission’s gaze....”

Id., p. 18. Intervenors are not an irritant — they often are the Postal Service’s customers who need to be heard.

Just as the Commission used the lessons learned earlier to initiate the rulemaking in Docket No. RM2012-4, the Commission has again seen the value of intervenor participation in N-dockets. Properly maintaining due process for “users of the mailer, and an officer of the Commission ... to represent the interests of the general public” (39 U.S.C. § 3661(c)) will provide the greatest value to the Commission and, ultimately, to the Postal Service.

CONCLUSION

The Postal Service has requested an Advisory Opinion on its plan to reduce certain service standards necessitated by its desire to cut costs. Since the *raison d’etre* for the reduction in service standards is the dramatic restructuring of the mail processing network and associated projected cost savings, a careful consideration of estimated cost savings is highly pertinent to the Commission’s forthcoming Advisory Opinion. It has been suggested that the Postal Service’s estimated cost savings from large-scale closures may too optimistic. Moreover, testimony submitted by four witnesses show that the Postal Service could consolidate a large number of facilities, possibly as many as 200 of its existing 477 plants, before it becomes necessary to consider the dramatic changes to existing service standards. Fortunately, the Postal Service modified plan allows it to progress in steps.

Valpak believes that the Postal Service needs to move ahead, and urges the Commission to find the Postal Service's latest proposal in harmony with the policies of Title 39. The Postal Service's modified schedule will allow the Postal Service to make its changes judiciously. A total of 48 plants are scheduled to be consolidated by August 31, 2012. The final post implementation reviews ("PIRs") of those closures are due to be available by November 30, 2013. USPS Response to Presiding Officer's Information Request No. 10, Question 3a. The Postal Service should be able to review the results of those 48 PIRs (along with any others that then might be available) to develop an improved estimate of further savings from eliminating overnight delivery for all but presort First-Class Mail prior to the second round of plant closings and implementing reduced service standards.

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